EXELIXIS, INC.
Form 10-Q
May 02, 2018
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 30, 2018
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 000-30235
EXELIXIS, INC.
(Exact name of registrant as specified in its charter)

Delaware	04-3257395
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

210 East Grand Ave.
South San Francisco, CA 94080
(650) 837-7000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)
Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨
Emerging growth company	¨		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of April 23, 2018, there were 296,866,380 shares of the registrant's common stock outstanding.

Table of Contents

EXELIXIS, INC.
QUARTERLY REPORT ON FORM 10-Q
INDEX

PART I - FINANCIAL INFORMATION		
Item 1.	Financial Statements	3
	Condensed Consolidated Balance Sheets	3
	Condensed Consolidated Statements of Operations	4
	Condensed Consolidated Statements of Comprehensive Income	4
	Condensed Consolidated Statements of Cash Flows	5
	Notes to Condensed Consolidated Financial Statements	6
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	26
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	35
Item 4.	Controls and Procedures	35
PART II - OTHER INFORMATION		
Item 1.	Legal Proceedings	36
Item 1A.	Risk Factors	36
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	56
Item 3.	Defaults Upon Senior Securities	56
Item 4.	Mine Safety Disclosures	56
Item 5.	Other Information	57
Item 6.	Exhibits	57
SIGNATURES		

Table of Contents

PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
EXELIXIS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)
(unaudited)

	March 31, 2018	December 31, 2017*
ASSETS		
Current assets:		
Cash and cash equivalents	$232,331	$183,164
Short-term investments	194,589	204,607
Short-term restricted cash and investments	504	504
Trade and other receivables, net	91,999	81,192
Inventory, net	7,563	6,657
Unbilled collaboration revenue	31,844	—
Prepaid expenses and other current assets	6,850	8,750
Total current assets	565,680	484,874
Long-term investments	96,710	64,255
Long-term restricted cash and investments	1,500	4,646
Property and equipment, net	45,412	25,743
Goodwill	63,684	63,684
Other long-term assets	1,929	12,092
Total assets	$774,915	$655,294
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$11,078	$9,575
Accrued compensation and benefits	20,756	21,073
Accrued clinical trial liabilities	15,351	19,849
Accrued collaboration liabilities	7,974	8,974
Rebates and fees due to customers	11,989	7,565
Current portion of deferred revenue	—	31,984
Other current liabilities	17,711	16,150
Total current liabilities	84,859	115,170
Long-term portion of deferred revenue	3,177	238,520
Other long-term liabilities	17,113	16,643
Total liabilities	105,149	370,333
Commitments (Note 11)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 10,000,000 shares authorized and no shares issued	—	—
Common stock, $0.001 par value; 400,000,000 shares authorized; issued and outstanding: 296,694,330 and 296,209,426 at March 31, 2018 and December 31, 2017, respectively	297	296
Additional paid-in capital	2,125,166	2,114,184
Accumulated other comprehensive loss	(887)	(347)
Accumulated deficit	(1,454,810)	(1,829,172)
Total stockholders' equity	669,766	284,961
Total liabilities and stockholders' equity	$774,915	$655,294

* The Condensed Consolidated Balance Sheet as of December 31, 2017 has been derived from the audited financial statements as of that date.

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Revenues:		
Net product revenues	$134,272	$68,877
Collaboration revenues	78,074	12,010
Total revenues	212,346	80,887
Operating expenses:		
Cost of goods sold	5,639	3,203
Research and development	37,757	23,210
Selling, general and administrative	52,643	34,288
Total operating expenses	96,039	60,701
Income from operations	116,307	20,186
Other income (expense), net:		
Interest income	1,895	1,113
Interest expense	—	(4,420)
Other, net	169	(45)
Total other income (expense), net	2,064	(3,352)
Income before income taxes	118,371	16,834
Provision for income taxes	2,514	134
Net income	$115,857	$16,700
Net income per share, basic	$0.39	$0.06
Net income per share, diluted	$0.37	$0.05
Shares used in computing net income per share, basic	296,421	290,870
Shares used in computing net income per share, diluted	313,691	309,535

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Net income	$115,857	$16,700
Other comprehensive (loss) income [(1)]	(540)	90
Comprehensive income	$115,317	$16,790

(1) Other comprehensive (loss) income consisted solely of unrealized gains or losses, net, on available-for-sale securities arising during the periods presented. Reclassification adjustments to net income resulting from realized gains or losses on the sale of securities were nominal and there was no income tax expense related to other comprehensive income during those periods.

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2018	2017
Net income	$ 115,857	$ 16,700
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	371	281
Stock-based compensation	9,305	4,713
Amortization of debt discounts and debt issuance costs	—	89
Interest paid in kind	—	2,068
Gain on other equity investments	(209)	—
Other	1,722	680
Changes in assets and liabilities:		
Trade and other receivables, net	(10,755)	6,541
Inventory, net	(906)	34
Unbilled collaboration revenue	(38,014)	—
Prepaid expenses and other current assets	1,900	(881)
Other long-term assets	(346)	(19)
Accounts payable	(183)	(1,916)
Accrued compensation and benefits	(317)	(5,844)
Accrued clinical trial liabilities	(4,498)	347
Accrued collaboration liabilities	(1,000)	—
Deferred revenue	(2,652)	35,139
Other current and long-term liabilities	1,533	10,926
Net cash provided by operating activities	71,808	68,858
Cash flows from investing activities:		
Purchases of property and equipment and other, net	(2,947)	(804)

Purchases of investments	(116,537)		(124,494)	
Proceeds from maturities of investments	87,504		122,507	
Proceeds from sale of investments	6,238		37,294	
Proceeds from other equity investments	209		—	
Net cash (used in) provided by investing activities	(25,533)		34,503	
Cash flows from financing activities:				
Principal repayments of debt	—		(80,000)	
Proceeds from exercise of stock options	1,875		9,675	
Taxes paid related to net share settlement of equity awards	(2,129)		(1,543)	
Net cash used in financing activities	(254)		(71,868)	
Net increase in cash, cash equivalents and restricted cash	46,021		31,493	
Cash, cash equivalents and restricted cash at beginning of period	188,314		155,836	
Cash, cash equivalents and restricted cash at end of period	$ 234,335		$ 187,329	

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

Table of Contents

EXELIXIS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Exelixis, Inc. ("Exelixis," "we," "our" or "us") is a biotechnology company committed to the discovery, development and commercialization of new medicines to improve care and outcomes for people with cancer. Since our founding in 1994, three products discovered at Exelixis have progressed through clinical development, received regulatory approval, and entered the marketplace. Two are derived from cabozantinib, an inhibitor of multiple tyrosine kinases including MET, AXL, VEGF receptors, and RET: CABOMETYX® (cabozantinib) tablets approved for advanced renal cell carcinoma ("RCC"); and COMETRIQ® (cabozantinib) capsules approved for progressive, metastatic medullary thyroid cancer. The third product, COTELLIC® (cobimetinib) tablets, is an inhibitor of MEK, marketed under a collaboration agreement with Genentech, Inc. (a member of the Roche Group) ("Genentech"), and is approved as part of a combination regimen to treat advanced melanoma.

Basis of Consolidation

The accompanying Condensed Consolidated Financial Statements include the accounts of Exelixis and those of our wholly-owned subsidiaries. These entities' functional currency is the U.S. dollar. All intercompany balances and transactions have been eliminated.

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and pursuant to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the results of operations and cash flows for the periods presented have been included.

We have adopted a 52- or 53-week fiscal year policy that generally ends on the Friday closest to December 31st. Fiscal year 2018 will end on December 28, 2018 and fiscal year 2017 ended on December 29, 2017. For convenience, references in this report as of and for the fiscal periods ended March 30, 2018 and March 31, 2017, and as of and for the fiscal years ended December 28, 2018 and December 29, 2017, are indicated as being as of and for the periods ended March 31, 2018 and March 31, 2017, and the years ended December 31, 2018 and December 31, 2017, respectively. Similarly, references in this report to the first day of the fiscal year ended December 28, 2018 are indicated as being as of January 1, 2018.

Operating results for the three months ended March 31, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or for any future period. These Condensed Consolidated Financial Statements and Notes thereto should be read in conjunction with the Consolidated Financial Statements and Notes thereto for the year ended December 31, 2017, included in our Annual Report on Form 10-K filed with the SEC on February 26, 2018.

Segment Information

We operate in one business segment which focuses on discovery, development and commercialization of new medicines to improve care and outcomes for people with cancer. Our Chief Executive Officer, as the chief operating decision-maker, manages and allocates resources to our operations on a total consolidated basis. Consistent with this decision-making process, our Chief Executive Officer uses consolidated, single-segment financial information for purposes of evaluating performance, forecasting future period financial results, allocating resources and setting incentive targets.

All of our long-lived assets are located in the U.S. See "Note 2. Revenues" for enterprise-wide disclosures about product sales, revenues from major customers and by geographic region.

Table of Contents

Use of Estimates

The preparation of the accompanying Condensed Consolidated Financial Statements conforms to accounting principles generally accepted in the U.S. which requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, equity, revenues and expenses, and related disclosures. On an ongoing basis, management evaluates its estimates including, but not limited to: those related to revenue recognition, including determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price of performance obligations, and variable consideration such as rebates, chargebacks, sales returns and sales allowances as well as milestones included in collaboration arrangements; the amounts of revenues and expenses under our profit and loss sharing agreement; recoverability of inventory; the accrual for certain liabilities including accrued clinical trial liability; and valuations of awards used to determine stock-based compensation. We base our estimates on historical experience and on various other market-specific and other relevant assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from those estimates.

Reclassifications

Certain prior period amounts on the accompanying Condensed Consolidated Financial Statements have been reclassified to conform to current period presentation.

Restricted Cash

In January 2018, we adopted Accounting Standards Update (“ASU”) No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force), (“ASU 2016-18”). ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents are included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 was adopted using the retrospective transition method in the accompanying Condensed Consolidated Financial Statements. As a result of the adoption of ASU 2016-18, we no longer include purchases of restricted cash and proceeds from maturities of restricted cash in our cash flows from investing activities. The adoption of ASU 2016-18 did not impact the Net cash provided by investing activities for the three months ended March 31, 2017.

See “Note 4. Cash and Investments - Cash, Cash Equivalents and Restricted Cash” for a reconciliation of cash and cash equivalents presented in our previously published Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2017 and Cash, cash equivalents and restricted cash reported in the accompanying Condensed Consolidated Statements of Cash Flows for the same period.

Revenue

Recently Adopted Accounting Pronouncements

On January 1, 2018, we adopted ASU No. 2014-09, Revenue from Contracts with Customers (Accounting Standards Codification Topic 606) (“Topic 606”) using the modified retrospective method applied to those contracts which were not completed as of January 1, 2018. Results for the three months ended March 31, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under previous revenue recognition guidance, Accounting Standards Codification Topic 605: Revenue Recognition (“Topic 605”).

Table of Contents

The adoption of Topic 606 did not have an impact on our recognition of revenue from product sales. We recorded a net reduction of $258.5 million to opening accumulated deficit as of January 1, 2018, due to the cumulative impact of adopting Topic 606, with the impact primarily relating to a change in the recognition of upfront and non-substantive milestone payments received related to our collaboration arrangements with Ipsen Pharma SAS ("Ipsen") and Takeda Pharmaceutical Company Ltd. ("Takeda"). The impact of the adoption of Topic 606 on contract assets, contract liabilities and accumulated deficit balances as of January 1, 2018 was as follows (in thousands):

	December 31, 2017	Adjustments Due to the Adoption of Topic 606	January 1, 2018
Contract assets: unbilled collaboration revenue, gross:			
Current portion	$—	$9,588	$9,588
Long-term portion	$—	$12,247	$12,247
Contract liabilities: deferred revenue, gross:			
Current portion	$31,984	$(23,591)	$8,393
Long-term portion	$238,520	$(213,079)	$25,441
Accumulated deficit	$(1,829,172)	$258,505	$(1,570,667)

The adjustments due to the adoption of Topic 606 primarily related to a reduction in deferred revenue driven by the allocation of the transaction price to our license performance obligations in the Ipsen and Takeda collaborations, which were determined to be functional intellectual property that was transferred at a point in time and as a result, revenue was recorded at a point in time. Previously under Topic 605, revenue related to the upfront payments and one non-substantive milestone payment earned 2016 had been deferred over the estimated period of performance pursuant to the terms of the contract. Contract assets as of January 1, 2018 primarily related to estimated revenue for reimbursements for our continuing research and development services and the $10.0 million milestone from Ipsen's filing with the European Medicines Agency ("EMA") for cabozantinib, as a treatment for patients with previously treated advanced hepatocellular carcinoma ("HCC"), that was deemed probable under Topic 606 prior to January 1, 2018. Deferred revenue as of January 1, 2018 is related to the up-front, nonrefundable, fees and milestones earned that were allocated to our research and development services performance obligation which had not been satisfied as of that date. Contract assets and liabilities are netted by collaboration agreement on our Condensed Consolidated Balance Sheets; however, for illustration purposes the above amounts are shown prior to netting.

The impact of the adoption of Topic 606 on our Condensed Consolidated Balance Sheet and Statement of Operations as of and for the period ended March 31, 2018 was as follows (in thousands):

	March 31, 2018		
	As Reported	Balances Without the Adoption of Topic 606	Effect of Adoption Higher / (Lower)
Unbilled collaboration revenue	$31,844	$—	$31,844
Current portion of deferred revenue	$—	$30,288	$(30,288)
Other current liabilities	$17,711	$16,820	$891
Long-term portion of deferred revenue	$3,177	$230,948	$(227,771)
Accumulated deficit	$(1,454,810)	$(1,743,822)	$289,012

Table of Contents

	Three Months Ended March 31, 2018		
	As Reported	Balances Without the Adoption of Topic 606	Effect of Adoption Higher / (Lower)
Collaboration revenues	$78,074	$46,676	$ 31,398
Total revenues	$212,346	$180,948	$ 31,398
Income before income taxes	$118,371	$86,973	$ 31,398
Provision for income taxes	$2,514	$1,623	$ 891
Net income	$115,857	$85,350	$ 30,507
Net income per share, basic	$0.39	$0.29	$ 0.10
Net income per share, diluted	$0.37	$0.27	$ 0.10

Collaboration revenues recognized for the three months ended March 31, 2018 in accordance with Topic 606 included $45.8 million in revenue relating to a $50.0 million milestone from Ipsen for the approval of cabozantinib for the first-line treatment of advanced RCC that would not have been recognized under Topic 605. If we had not adopted Topic 606, we would have recognized a $10.0 million milestone during the three months ended March 31, 2018 upon the validation of Ipsen's filing with the EMA for cabozantinib as a treatment for patients with previously treated advanced HCC that was not recognized under Topic 606. The adoption of Topic 606 also resulted in a reduction of previously deferred revenue that was recorded as part of our adoption transition adjustment as of January 1, 2018.

Topic 606 supersedes all previous revenue recognition requirements in accordance with generally accepted accounting principles. This standard applies to all contracts with customers, except for contracts that are within the scope of other standards, such as leases, insurance, collaboration arrangements and financial instruments. Under Topic 606, an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration to which the entity is entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that we determine are within the scope of Topic 606, we perform the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) we satisfy a performance obligation. We only apply the five-step model to contracts when it is probable that we will collect the consideration it is entitled to in exchange for the goods or services we transfer to the customer.

Net Product Revenues

We sell our products principally to specialty distributors and specialty pharmacy providers, or collectively, our Customers. These Customers subsequently resell our products to health care providers and patients. In addition to distribution agreements with Customers, we enter into arrangements with health care providers and payors that provide for government-mandated and/or privately-negotiated rebates, chargebacks and discounts with respect to the purchase of our products. Revenues from product sales are recognized when the Customer obtains control of our product, which occurs at a point in time, typically upon delivery to the Customer.

Product Sales Discounts and Allowances

Revenues from product sales are recorded at the net sales price (transaction price), which includes estimates of variable consideration for which reserves are established and which result from discounts, chargebacks, rebates, co-pay assistance, returns and other allowances that are offered within contracts between us and our Customers, health care providers, payors and other indirect customers relating to the sales of our products. These reserves are based on the amounts earned or to be claimed on the related sales and are classified as reductions of accounts receivable (if the amount is payable to the Customer) or a current liability (if the amount is payable to a party other than a Customer). Where appropriate, these estimates take into consideration a range of possible outcomes that are probability-weighted for relevant factors such as our historical experience, current contractual and statutory

requirements, specific known market events and trends, industry data and forecast customer buying and payment patterns. Overall, these reserves reflect our best estimates of the amount of consideration to which we are entitled based on the terms of the contract. The amount of variable consideration that is included in the transaction price may be constrained, and is included in the net sales price only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized will not occur in a future period. Actual amounts of consideration ultimately received may differ from our estimates. If actual results in the future vary from our estimates, we will adjust these estimates, which would affect net product revenues and earnings in the period such variances become known.

Table of Contents

Chargebacks: Chargebacks are discounts that occur when contracted customers purchase directly from a specialty distributor. Contracted customers, which currently consist primarily of Public Health Service institutions, non-profit clinics, Federal government entities purchasing via the Federal Supply Schedule and Group Purchasing Organizations, and health maintenance organizations, generally purchase the product at a discounted price. The specialty distributor, in turn, charges back to us the difference between the price initially paid by the specialty distributor and the discounted price paid to the specialty distributor by the customer. The allowance for chargebacks is based on an estimate of sales to contracted customers.

Discounts for Prompt Payment: Our Customers in the U.S. receive a discount of 2% for prompt payment. We expect our Customers will earn 100% of their prompt payment discounts and, therefore, we deduct the full amount of these discounts from total product sales when revenues are recognized.

Rebates: Allowances for rebates include mandated discounts under the Medicaid Drug Rebate Program and other government programs. Rebate amounts owed after the final dispensing of the product to a benefit plan participant are based upon contractual agreements or legal requirements with public sector benefit providers, such as Medicaid. The allowance for rebates is based on statutory discount rates and expected utilization. Our estimates for the expected utilization of rebates are based on customer and payer data received from the specialty pharmacies and distributors and historical utilization rates. Rebates are generally invoiced by the payer and paid in arrears, such that the accrual balance consists of an estimate of the amount expected to be incurred for the current quarter's shipments to our customers, plus an accrual balance for known prior quarter's unpaid rebates. If actual future rebates vary from estimates, we may need to adjust our accruals, which would affect net product revenues in the period of adjustment.

Allowances for rebates also include the Medicare Part D Coverage Gap. In the U.S., the Medicare Part D prescription drug benefit mandates manufacturers to fund 50% of the Medicare Part D insurance coverage gap for prescription drugs sold to eligible patients. Our estimates for expected Medicare Part D coverage gap are based on customer and payer data received from specialty pharmacies and distributors and historical utilization rates. Funding of the coverage gap is invoiced and paid in arrears so that the accrual balance consists of an estimate of the amount expected to be incurred for the current quarters' shipments to patients, plus an accrual balance for known prior quarter's unpaid claims. If actual future funding varies from estimates, we may need to adjust our accruals, which would affect net product revenues in the period of adjustment.

Co-payment Assistance: Patients who have commercial insurance and meet certain eligibility requirements may receive co-payment assistance. We accrue a liability for co-payment assistance based on actual program participation and estimates of program redemption using customer data provided by the specialty pharmacies and distributors.

Other Customer Credits: We pay fees to our Customers for account management, data management and other administrative services. To the extent the services received are distinct from the sale of products to the Customer, these payments are classified in Selling, general and administrative expenses in our Condensed Consolidated Statements of Operations.

Collaboration Revenues

We enter into collaboration arrangements, under which we license certain rights to our intellectual property to third parties. The terms of these arrangements typically include payment to us for one or more of the following: non-refundable, up-front license fees; development, regulatory and commercial milestone payments; payments for product supply; development cost reimbursements; profit sharing arrangements; and royalties on net sales of licensed products. Except for profit sharing arrangements, each of these payment types are within the scope of Topic 606. As part of the accounting for these arrangements, we must develop assumptions that require judgment to determine the standalone selling price for each performance obligation identified in the contract. These key assumptions may include forecast revenues, clinical development timelines and costs, reimbursement rates for personnel costs, discount rates and probabilities of technical and regulatory success.

Up-front License Fees: If the license to our intellectual property is determined to be distinct from the other performance obligations identified in the arrangement, we recognize revenues from nonrefundable, up-front fees allocated to the license when the license is transferred to the licensee and the licensee is able to use and benefit from the license. For licenses that are bundled with other promises, we utilize judgment to assess the nature of the combined performance obligation to determine whether the combined performance obligation is satisfied over time or

at a point in time and, if over time, the appropriate method of measuring progress for purposes of recognizing revenue from non-refundable, up-

Table of Contents

front fees. We evaluate the measure of progress each reporting period and, if necessary, adjust the measure of performance and related revenue recognition.

Milestone Payments: At the inception of each arrangement that includes development milestone payments, we evaluate whether the milestones are considered probable of being reached and estimate the amount to be included in the transaction price using the most likely amount method. If it is probable that a significant revenue reversal would not occur, the associated milestone value is included in the transaction price. Milestone payments that are not within our or the licensee's control, such as regulatory approvals, are not considered probable of being earned until uncertainty associated with the approvals has been resolved. The transaction price is then allocated to each performance obligation, on a relative standalone selling price basis, for which we recognize revenue as or when the performance obligations under the contract are satisfied. At the end of each subsequent reporting period, we re-evaluate the probability of earning such development milestones and any related constraint, and if necessary, adjust our estimate of the overall transaction price. Any such adjustments are recorded on a cumulative catch-up basis, which would affect Collaboration revenues and earnings in the period of adjustment.

Product Supply Services: Arrangements that include a promise for future supply of drug product for either clinical development or commercial supply at the licensee's discretion are generally considered as options. We assess if these options provide a material right to the licensee and if so, they are accounted for as separate performance obligations.

Development Cost Reimbursements: Our Ipsen and Takeda arrangements include promises of future clinical development and drug safety services, as well as participation on certain joint committees. We have determined that these services collectively are distinct from the license provided to each partner and as such, these promises are accounted for as a separate performance obligation recorded over time. We record revenue for these services as the performance obligations are satisfied, which we estimate using internal development costs incurred and projections through the term of the arrangements.

Profit Sharing Arrangements: Under the terms of our collaboration agreement with Genentech for cobimetinib, we are entitled to a share of U.S. profits and losses received in connection with commercialization of cobimetinib. We are also entitled to low double-digit royalties on ex-U.S. net sales. We account for such arrangements in accordance with Accounting Standards Codification Topic 808, Collaborative Arrangements ("Topic 808"). We have determined that we are an agent under the agreement and therefore revenues are recorded net of costs incurred. We record U.S. profits and losses under the collaboration agreement in the period earned based on our estimate of those amounts. Historically, we have not recognized a profit for any annual period from the commercialization of cobimetinib in the U.S. Until we recognize or expect to recognize an annual profit under the agreement, losses are recognized as Selling, general and administrative expenses on the accompanying Condensed Consolidated Statements of Operations.

Royalties: For arrangements that include sales-based royalties, including milestone payments based on the level of sales, the license is deemed to be the predominant item to which the royalties relate and we recognize revenue at the later of (i) when the related sales occur, or (ii) when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied).

Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board ("FASB") issued ASU No. 2016-02, Leases (Topic 842), ("ASU 2016-02"). Under ASU 2016-02, a lessee will be required to recognize assets and liabilities for leases with lease terms of more than 12 months. Recognition, measurement, and presentation of expenses and cash flows arising from a lease by a lessee primarily will depend on its classification as a finance or operating lease. ASU 2016-02 will require a right-of-use asset to be recognized on the balance sheet for both types of leases. ASU 2016-02 also will require disclosures to help investors and other financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. These disclosures include qualitative and quantitative requirements, providing additional information about the amounts recorded in the financial statements. ASU 2016-02 must be adopted using a modified retrospective transition, and provides for certain practical expedients. Transition will require application of the new guidance at the beginning of the earliest comparative period presented. ASU 2016-02 is effective for all interim and annual reporting periods beginning after December 15, 2018, with early adoption permitted. We currently expect to early adopt this standard in the second quarter of 2018. Based on our initial evaluation of the impact of ASU 2016-02 on our build-to-suit lease of office and research facilities located in Alameda, California, we expect that the

amount we have capitalized as Property and equipment related to the building shells, will be derecognized upon the adoption of ASU 2016-02. Upon adoption of ASU 2016-02 we will also be required to recognize a right-of-use asset and lease liability related to this lease. The adoption of ASU 2016-02 could also

Table of Contents

change the nature of future expenses related to the build-to-suit lease, reducing future depreciation and interest expense, which would be offset by an increase in lease expense. We are continuing to assess the impact of ASU No. 2016-02 on our consolidated financial statements.

In January 2018, the FASB issued the exposure document Proposed Accounting Standards Update—Leases (Topic 842): Targeted Improvements. In issuing this exposure draft, the FASB proposes allowing another transition method for ASU 2016-02, which would allow the transition to the new lease standard by recognizing a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. This Proposed Accounting Standards Update, if issued as a final ASU by the FASB, could impact our method of adoption of ASU 2016-02.

NOTE 2. REVENUES

Revenues by disaggregated category were as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Product revenues:		
Gross product revenues	$159,436	$77,959
Discounts and allowances	(25,164)	(9,082)
Net product revenues	134,272	68,877
Collaboration revenues:		
License revenues [1]	69,030	11,214
Research and development services revenues [2]	10,099	1,132
Product supply revenues, net	(1,055)	(336)
Total collaboration revenues	78,074	12,010
Total revenues	$212,346	$80,887

(1) License revenues for the three months ended March 31, 2018 included revenues related to the portion of two milestones that were allocated to the transfer of intellectual property licenses and were fully recognized in the current period and royalty revenue from Ipsen and Genentech. License revenues for the three months ended March 31, 2017 included the recognition of deferred revenues from upfront payments and a non-substantive milestone that were being amortized over various periods, royalty revenues from Ipsen and Genentech and one milestone. Upon the adoption of Topic 606, the allocation of proceeds from our collaboration partners between licenses and research and development services as well as the timing of recognition has changed. Therefore, among other changes, as of January 1, 2018, the portion of proceeds allocated to intellectual property licenses for our Ipsen and Takeda collaboration agreements are recognized immediately and license revenues no longer includes revenues related to the amortization of deferred revenue.

(2) Research and development services revenues for three months ended March 31, 2018 included the recognition of deferred revenue for the portion of the upfront payments and milestones that were allocated to the research and development services which are being amortized through early 2030, as well as development cost reimbursements earned on our collaboration agreements. As described above, we did not allocate any of our upfront payments or milestones to research and development services prior to the adoption of Topic 606 and therefore research and development services revenues for the three months ended March 31, 2017 included only development cost reimbursements earned on our collaboration agreements.

During the three months ended March 31, 2018, net product revenues and license revenues related to goods transferred at a point in time and research and development services revenues related to services performed over time. Product supply revenues, net, which include the royalty payable to GlaxoSmithKline (“GSK”) on net sales by Ipsen, were recorded in accordance with Topic 808 for all periods presented. Our remaining revenues were recorded in accordance with Topic 606 during 2018 and Topic 605 in prior periods.

Net product revenues disaggregated by product were as follows (in thousands):

	Three Months Ended March 31,

	2018	2017
CABOMETYX	$128,934	$62,359
COMETRIQ	5,338	6,518
Net product revenues	$134,272	$68,877

Table of Contents

Total revenues disaggregated by significant customer were as follows (dollars in thousands):

	Three Months Ended March 31,			
	2018		2017	
	Dollars	Percent of total	Dollars	Percent of total
Ipsen	$53,809	25 %	$4,530	6 %
Caremark L.L.C.	$26,388	12 %	$13,819	17 %
Affiliates of McKesson Corporation	$21,331	10 %	$11,278	14 %
Diplomat Specialty Pharmacy	$20,147	9 %	$19,850	25 %
Accredo Health, Incorporated	$18,286	9 %	$9,440	12 %

Total revenues disaggregated by geographic region were as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
U.S.	$135,620	$73,675
Europe	$53,809	$4,530
Rest of the world	$22,917	$2,682

Net product revenues are attributed to regions based on the ship-to location. Collaboration revenues are attributed to regions based on the location of our collaboration partners' headquarters.

Product Sales Discounts and Allowances

The activities and ending reserve balances for each significant category of discounts and allowances (which constitute variable consideration) were as follows (in thousands):

	Chargebacks and Discounts for Prompt Payment	Other Customer Credits/Fees and Co-pay Assistance	Rebates	Returns	Total
Balance at December 31, 2017	$ 1,928	$ 1,795	$5,770	$ —	$9,493
Provision related to sales made in:					
Current period	14,475	4,197	6,625	—	25,297
Prior periods	(331)	—	199	—	(132)
Payments and customer credits issued	(13,556)	(3,294)	(3,303)	—	(20,153)
Balance at March 31, 2018	$ 2,516	$ 2,698	$9,291	$ —	$14,505

Chargebacks and discounts for prompt payment are recorded as a reduction of trade receivables and the remaining reserve balances are classified as Other current liabilities in the accompanying Condensed Consolidated Balance Sheets.

Table of Contents

Contract Assets and Liabilities

We receive payments from our licensees based on billing schedules established in each contract. Amounts are recorded as accounts receivable when our right to consideration is unconditional. Upfront and milestone payments may require deferral of revenue recognition to a future period until we perform our obligations under these arrangements and are recorded as deferred revenue upon receipt or when due. We may also recognize revenue in advance of the contractual billing schedule and such amounts are recorded as unbilled collaboration revenue when recognized. Changes in our contract assets and liabilities under Topic 606 were as follows (in thousands):

	Contract Assets: Unbilled Collaboration Revenue		Contract Liabilities: Deferred Revenue	
	Current Portion	Long-term Portion	Current Portion	Long-term Portion
Balance at December 31, 2017	$—	$ —	$31,984	$238,520
Adoption of Topic 606	9,588	12,247	(23,591)	(213,079)
Balance at January 1, 2018	9,588	12,247	8,393	25,441
Increases as a result of a change in transaction price and recognition of revenues as services are performed	46,006	1,166	—	—
Transfer to receivables from contract assets recognized at the beginning of the period	(9,159)	—	—	—
Increases as a result of the deferral of milestones earned in period, excluding amounts recognized as revenue	—	—	173	666
Revenue recognized that was included in the contract liability balance at the beginning of the period	—	—	(3,492)	—
Other adjustments [1]	(14,591)	(13,413)	(5,074)	(22,930)
Balance at March 31, 2018	$31,844	$ —	$—	$3,177

(1) Includes reclassification of deferred revenue from long-term to current and adjustments made due to netting of contract assets and liabilities by collaboration agreement.

During the three months ended March 31, 2018, we recognized $71.3 million in revenues under Topic 606 for performance obligations satisfied in previous periods. Such revenues primarily related to milestone and royalty payments allocated to our license performance obligations of our collaborations with Ipsen and Daiichi Sankyo Company, Limited (“Daiichi Sankyo”).

NOTE 3. COLLABORATION AGREEMENTS

From time to time, we enter into collaborative arrangements for the development, manufacture and/or commercialization of products and/or product candidates. These collaborations generally provide for non-refundable up-front license fees, development and commercial performance milestone payments, payments for product supply, development cost reimbursements, royalty payments and/or profit sharing. See “Note 2. Revenues” for information on collaboration revenues recognized during the three months ended March 31, 2018 and 2017.

Ipsen Collaboration

In February 2016, we entered into a collaboration and license agreement with Ipsen for the commercialization and further development of cabozantinib. Pursuant to the terms of the collaboration agreement, Ipsen received exclusive commercialization rights for current and potential future cabozantinib indications outside of the U.S., Canada and Japan. The collaboration agreement was subsequently amended in December 2016 to include commercialization rights in Canada. We have also agreed to collaborate with Ipsen on the development of cabozantinib for current and potential future indications. The parties’ efforts are governed through a joint steering committee and appropriate subcommittees established to guide and oversee the collaboration’s operation and strategic direction; provided, however, that we retain final decision-making authority with respect to cabozantinib’s ongoing development.

14

Table of Contents

In consideration for the exclusive license and other rights contained in the collaboration agreement, including commercialization rights in Canada, Ipsen paid us aggregate upfront payments of $210.0 million. As of December 31, 2017 we had earned various milestones totaling $125.0 million. During the three months ended March 31, 2018 we earned an additional $10.0 million milestone upon Ipsen's filing with the EMA for cabozantinib as a treatment for patients with previously treated advanced HCC.

We are also eligible to receive future development and regulatory milestone payments, totaling up to an additional $199.0 million, including a $40.0 million milestone upon the EMA's approval of cabozantinib as a treatment for patients with previously treated advanced HCC, a $50.0 million milestone upon the EMA's approval of cabozantinib as a first-line treatment of advanced RCC and additional milestone payments for other future indications and/or jurisdictions. The collaboration agreement also provides that we will be eligible to receive contingent payments of up to $545.5 million associated with the achievement of specified levels of Ipsen sales to end users. We will also receive royalties on net sales of cabozantinib by Ipsen outside of the U.S. and Japan. Excluding Ipsen sales in Canada, we received a 2% royalty on the initial $50.0 million of net sales, which was achieved in the fourth quarter of 2017, and are entitled to receive a 12% royalty on the next $100.0 million of net sales, and following this initial $150.0 million of net sales, we are then entitled to receive a tiered royalty of 22% to 26% on annual net sales. These tiers will reset each calendar year. In Canada, we are entitled to receive a tiered royalty of 22% on the first Can$30.0 million of annual net sales and a tiered royalty thereafter, up to 26% on annual net sales; these tiers will also reset each calendar year.

We are primarily responsible for funding cabozantinib-related development costs for those trials in existence at the time we entered into the collaboration agreement with Ipsen; global development costs for additional trials are shared between the parties, with Ipsen reimbursing us for 35% of such costs, provided Ipsen chooses to opt into such trials. In accordance with the collaboration agreement, Ipsen has opted into and is co-funding: CheckMate 9ER, the phase 3 pivotal trial evaluating the combination of cabozantinib with nivolumab versus sunitinib in patients with previously untreated, advanced or metastatic RCC being conducted in collaboration with Bristol-Myers Squibb Company ("BMS"); CheckMate 040, the phase 1/2 study evaluating the combination of cabozantinib with nivolumab in patients with both previously treated and previously untreated advanced HCC being conducted in collaboration with BMS (though Ipsen will not be co-funding the triplet arm of the study evaluating cabozantinib with nivolumab and ipilimumab); and the phase 1b trial evaluating cabozantinib in combination with atezolizumab in locally advanced or metastatic solid tumors being conducted in collaboration with the Roche Group.

We remain responsible for the manufacture and supply of cabozantinib for all development and commercialization activities under the collaboration agreement. In connection with the collaboration agreement, we entered into a supply agreement with Ipsen to supply finished, labeled drug product to Ipsen for distribution in the territories outside of the U.S. and Japan for the term of the collaboration agreement. The product will be supplied at our cost, as defined in the agreement, which excludes the 3% royalty we are required to pay GSK on Ipsen's net sales of any product incorporating cabozantinib.

Unless terminated earlier, the collaboration agreement has a term that continues, on a product-by-product and country-by-country basis, until the latter of (i) the expiration of patent claims related to cabozantinib, (ii) the expiration of regulatory exclusivity covering cabozantinib or (iii) ten years after the first commercial sale of cabozantinib, other than COMETRIQ. The supply agreement will continue in effect until expiration or termination of the collaboration agreement. The collaboration agreement may be terminated for cause by either party based on uncured material breach of either the collaboration agreement or the supply agreement by the other party, bankruptcy of the other party or for safety reasons. We may terminate the collaboration agreement if Ipsen challenges or opposes any patent covered by the collaboration agreement. Ipsen may terminate the collaboration agreement if the U.S. Food and Drug Administration ("FDA") or EMA orders or requires substantially all cabozantinib clinical trials to be terminated. Ipsen also has the right to terminate the collaboration agreement on a region-by-region basis after the first commercial sale of cabozantinib in advanced RCC in the given region. Upon termination by either party, all licenses granted by us to Ipsen will automatically terminate, and, except in the event of a termination by Ipsen for our material breach, the licenses granted by Ipsen to us shall survive such termination and shall automatically become worldwide, or, if Ipsen terminated only for a particular region, then for the terminated region. Following termination by us for

Ipsen's material breach, or termination by Ipsen without cause or because we undergo a change of control by a party engaged in a competing program, Ipsen is prohibited from competing with us for a period of time.

We identified the following performance obligations under the collaboration agreement with Ipsen: (1) an exclusive license for the commercialization and further development of cabozantinib, as described above; and (2) research and

Table of Contents

development services which includes certain committed studies for the development of cabozantinib, pharmacovigilance services and participation on the joint steering and development committees (as defined in the collaboration agreement).

We evaluated the collaboration agreement with Ipsen under Topic 606 as of January 1, 2018. Based on the evaluation as of that date, the up-front, nonrefundable fees, the milestones earned and royalties earned as of December 31, 2017, the $10.0 million milestone we expected to earn in the first quarter of 2018 upon Ipsen's filing with the EMA for cabozantinib as a treatment for patients with previously treated advanced HCC, and the estimated reimbursements for our research and development services performance obligation constituted the amount of the consideration to be included in the transaction price. The transaction price was allocated to the performance obligations identified based on our best estimate of the relative standalone selling price. Other than the $10.0 million HCC filing milestone discussed above, variable consideration related to regulatory and development milestones not previously recognized was constrained due to the fact that it was not probable that a significant reversal of cumulative revenue would not occur, given the inherent uncertainty of success with these milestones. Any variable consideration related to sales based milestones, including royalties, will be recognized when the related sales occur as these amounts have been determined to relate predominantly to the license transferred to Ipsen and therefore is recognized at the later of when the performance obligation is satisfied or the related sales occur. We will re-evaluate the transaction price in each reporting period and as uncertain events are resolved or other changes in circumstances occur.

Revenues for our research and development services performance obligation are being recognized using the inputs method based on our internal development projected cost estimates through early 2030, which is the current estimated patent expiration of cabozantinib in the European Union. Revenues related to our license performance obligation are recorded immediately as our license represents functional intellectual property that was transferred at a point in time, upon execution of the collaboration agreement. As of March 31, 2018, $54.0 million of the transaction price allocated to our research and development services performance obligation had not been satisfied.

As of March 31, 2018, we determined that we expect to earn a $50.0 million milestone in the second quarter of 2018 for the approval of cabozantinib for the first-line treatment of advanced RCC by the European Commission ("EC"). The determination was made following the Committee for Medicinal Products for Human Use's ("CHMP") positive opinion of cabozantinib for the first-line treatment of advanced RCC. The positive CHMP opinion is being reviewed by the EC as part of their approval process. Our determination that we expect to earn that $50.0 million milestone resulted in a change in the overall transaction price of the collaboration agreement, as it was probable that a significant reversal of cumulative revenue would not occur, triggering recognition of $45.8 million in additional collaboration revenues during the three months ended March 31, 2018 which was recorded as Unbilled collaboration revenue as of March 31, 2018. The remaining portion of the milestone will be recorded as we continue to satisfy our research and development services performance obligation and once we have an unconditional right to payment, upon approval of cabozantinib for the first-line treatment of advanced RCC by the EC.

As of March 31, 2018, the net contract asset for the collaboration agreement with Ipsen was $31.8 million, which was included in current Unbilled collaboration revenue on the accompanying Condensed Consolidated Balance Sheets.

Collaboration revenues under the collaboration agreement with Ipsen were as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Ipsen collaboration revenues	$53,809	$4,530

Takeda Collaboration

In January 2017, we entered into a collaboration and license agreement with Takeda for the commercialization and further clinical development of cabozantinib in Japan. Pursuant to the terms of the collaboration agreement, Takeda has exclusive commercialization rights for current and potential future cabozantinib indications in Japan. The parties have also agreed to collaborate on the future clinical development of cabozantinib in Japan. The operation and strategic direction of the parties' collaboration is governed through a joint executive committee and appropriate subcommittees.

In consideration for the exclusive license and other rights contained in the collaboration agreement, we received a $50.0 million upfront nonrefundable payment from Takeda.

We are eligible to receive development, regulatory and first-sale milestone payments of up to $95.0 million related to second-line RCC, first-line RCC and second-line HCC, as well as additional development, regulatory and first-sale

Table of Contents

milestones payments for potential future indications. The collaboration agreement also provides that we are eligible to receive pre-specified payments of up to $83.0 million associated with potential sales milestones. We consider the contingent payments due to us upon the achievement of specified sales volumes to be similar to royalty payments. We will also receive royalties on net sales of cabozantinib in Japan. We are entitled to receive a tiered royalty of 15% to 24% on the initial $300.0 million of net sales, and after the initial $300.0 million of net sales, we are then entitled to receive a tiered royalty of 20% to 30% on annual net sales. These tiers will reset each calendar year. Takeda is responsible for 20% of the costs associated with the global cabozantinib development plan's current and future trials, provided Takeda opts into such trials, and 100% of costs associated with the cabozantinib development activities that are exclusively for the benefit of Japan. In accordance with the collaboration agreement, Takeda has opted into and is co-funding CheckMate 9ER, the phase 3 pivotal trial evaluating the combination of cabozantinib with nivolumab versus sunitinib in patients with previously untreated, advanced or metastatic RCC being conducted in collaboration with BMS.

Pursuant to the terms of the collaboration agreement, we are responsible for the manufacture and supply of cabozantinib for all development and commercialization activities under the collaboration, and consequently, we entered into a clinical supply agreement covering the manufacture and supply of cabozantinib to Takeda, as well as a quality agreement setting forth, in detail, the quality assurance arrangements and procedures for our manufacture of cabozantinib. We will record reimbursements for development costs as revenue as the development services represent a part of our ongoing major or central operations.

Unless earlier terminated, the collaboration agreement has a term that continues, on a product-by-product basis, until the earlier of (i) two years after first generic entry with respect to such product in Japan or (ii) the later of (A) the expiration of patent claims related to cabozantinib and (B) the expiration of regulatory exclusivity covering cabozantinib in Japan. The collaboration agreement may be terminated for cause by either party based on uncured material breach by the other party, bankruptcy of the other party or for safety reasons. For clarity, Takeda's failure to achieve specified levels of commercial performance, based upon sales volume and/or promotional effort, during the first six years of the collaboration shall constitute a material breach of the collaboration agreement. We may terminate the agreement if Takeda challenges or opposes any patent covered by the collaboration agreement. At any time prior to August 1, 2023, the parties may mutually agree to terminate the collaboration agreement if Japan's Pharmaceuticals and Medical Devices Agency is unlikely to grant any approval of the marketing authorization application in any cancer indication in Japan. After the commercial launch of cabozantinib in Japan, Takeda may terminate the collaboration agreement upon twelve months' prior written notice following the third anniversary of the first commercial sale of cabozantinib in Japan. Upon termination by either party, all licenses granted by us to Takeda will automatically terminate, and the licenses granted by Takeda to us shall survive such termination and shall automatically become worldwide.

We identified the following performance obligations under the collaboration agreement with Takeda: (1) an exclusive license for the commercialization and further development of cabozantinib, as described above; and (2) research and development services which includes certain committed studies for the development of cabozantinib, pharmacovigilance services and participation on the joint executive and development committees (as defined in the collaboration agreement).

We evaluated the collaboration agreement with Takeda under Topic 606 as of January 1, 2018. Based on the evaluation as of that date, the up-front, nonrefundable fees and the estimated reimbursements for our research and development services performance obligation constituted the amount of the consideration to be included in the transaction price. The transaction price was allocated to the performance obligations identified based on our best estimate of the relative standalone selling price. Variable consideration related to regulatory and development milestones not previously recognized was constrained due to the fact that it was not probable that a significant reversal of cumulative revenue would not occur, given the inherent uncertainty of success with these milestones. Any variable consideration related to sales based milestones, including royalties, will be recognized when the related sales occur as these amounts have been determined to relate predominantly to the license transferred to Takeda and therefore is recognized at the later of when the performance obligation is satisfied or the related sales occur. We will re-evaluate the transaction price in each reporting period and as uncertain events are resolved or other changes in circumstances

occur.

Revenues for our research and development services performance obligation are being recognized using the inputs method based on our internal development projected cost estimates through early 2030, which is the current estimated patent expiration of cabozantinib in Japan. Revenues related to our license performance obligation are recorded immediately as our license represents functional intellectual property that was transferred at a point in time, upon

Table of Contents

execution of the collaboration agreement. As of March 31, 2018, $28.7 million of the transaction price allocated to our research and development services performance obligation had not been satisfied.

As of March 31, 2018, the net contract liability for the collaboration agreement with Takeda was $3.2 million, which was included in Long-term deferred revenue on the accompanying Condensed Consolidated Balance Sheets.

Collaboration revenues under the collaboration agreement with Takeda were as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Takeda collaboration revenues	$2,917	$2,682

Genentech Collaboration

Royalty revenues on ex-U.S. sales and our share of the profits and losses recognized in connection with COTELLIC's commercialization in the U.S. were as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Royalty revenues on ex-U.S. sales	$1,349	$2,298
Profits and losses on U.S. commercialization	$1,373	$(626)

The royalty revenues on ex-U.S. sales were included in Collaboration revenues. Royalty revenues from the collaboration agreement with Genentech are based on amounts reported to us by our collaboration partner and are recorded when such information becomes available to us; beginning in the first quarter of 2017 such information became available in the current quarter and for 2016 such information was not available until the following quarter, meaning that through December 31, 2016 we recorded royalty revenues on a one quarter lag. As a result of this change, royalty revenues for the three months ended March 31, 2017 included $1.1 million in royalty revenues for sales in the fourth quarter of 2016 and $1.2 million in royalty revenues for sales in the first quarter of 2017.

Profits and losses on the U.S. commercialization of COTELLIC were included in Selling, general and administrative expenses in our Condensed Consolidated Statements of Operations; we are including the profit for the three months ended March 31, 2018 in Selling, general and administrative expenses as we are expecting an overall loss for the year ended December 31, 2018.

GlaxoSmithKline Collaboration

Royalties accruing to GSK in connection with the sales of COMETRIQ and CABOMETYX are included in Cost of goods sold for net sales by us and as a reduction of Collaboration revenues for net sales by Ipsen on the accompanying Condensed Consolidated Statements of Operations. Such royalties were as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Royalties accruing to GSK	$5,125	$2,737

StemSynergy Collaboration

In January 2018, we entered into an exclusive collaboration and license agreement with StemSynergy Therapeutics, Inc. ("StemSynergy") for the discovery and development of novel oncology compounds targeting Casein Kinase 1 alpha ("CK1 ") a component of the Wnt signaling pathway implicated in key oncogenic processes. Under the terms of the agreement, we will partner with StemSynergy to conduct preclinical and clinical studies with compounds targeting CK1 . We paid StemSynergy an upfront payment of $3.0 million for initial research and development funding and StemSynergy is eligible to receive up to an additional $3.5 million of such funding. The $3.0 million payment we made during the three months ended March 31, 2018 is included in Research and development expenses in our Condensed Consolidated Statements of Operations. StemSynergy will also be eligible for up to $56.5 million in milestones for the first product to emerge from the collaboration, including preclinical and clinical development and

regulatory milestone payments, commercial milestones, as well as single-digit royalties on worldwide sales. We will be solely responsible for the commercialization of products that arise from the collaboration.

Table of Contents

Other Collaborations

For a description of our other existing collaboration agreements, see “Note 2. Collaboration Agreements” to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 26, 2018.

We have determined that each of our other existing collaboration agreements have one performance obligation, the delivery of an intellectual property license to each collaboration partner, which was satisfied for all such agreements prior to the adoption of Topic 606. As a result, any consideration earned and received from these collaborations will be recognized immediately as the licenses we provided represent functional intellectual property that was transferred at a point in time prior to the adoption of Topic 606, when the agreements were executed. Potential variable consideration for these collaborations related to regulatory and development milestones was constrained due to the fact that it was not probable that a significant reversal of cumulative revenue would not occur, given the inherent uncertainty of success with these milestones. Any variable consideration related to sales based milestones, including royalties, will be recognized when the related sales occur as these amounts have been determined to relate predominantly to the licenses transferred and therefore are recognized at the later of when the performance obligation is satisfied or the related sales occur.

In February 2018 we earned a $20.0 million milestone, which is included in Collaboration revenues during the three months ended March 31, 2018, upon Daiichi Sankyo’s submission of a regulatory application to the Japanese Pharmaceutical and Medical Devices Agency for esaxerenone as a treatment for patients with essential hypertension.

NOTE 4. CASH AND INVESTMENTS

Cash, Cash Equivalents and Restricted Cash

A reconciliation of Cash, cash equivalents, and restricted cash reported within the Condensed Consolidated Balance Sheets to the amount reported within the Condensed Consolidated Statements of Cash Flows was as follows (in thousands):

	March 31, 2018	December 31, 2017	March 31, 2017	December 31, 2016
Cash and cash equivalents	$232,331	$ 183,164	$183,179	$151,686
Restricted cash included in short-term restricted cash and investments	504	504	—	—
Restricted cash included in long-term restricted cash and investments	1,500	4,646	4,150	4,150
Cash, cash equivalents, and restricted cash as reported within the Condensed Consolidated Statements of Cash Flows	$234,335	$ 188,314	$187,329	$155,836

Restricted cash includes certificates of deposit used to collateralize letters of credit and, in prior periods, a purchasing card program. See “Note 11. Commitments” for a description of the collateral requirements for our letters of credit and the purchasing card program.

Investments Available-for-sale

Investments by security type were as follows; the amounts presented exclude cash, but include investments classified as cash equivalents (in thousands):

	March 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$55,241	$ —	$ —	$55,241
Commercial paper	237,067	—	—	237,067
Corporate bonds	191,361	13	(843)	190,531
U.S. Treasury and government sponsored enterprises	21,490	—	(57)	21,433
Total	$505,159	$ 13	$ (900)	$504,272

Table of Contents

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$45,478	$ —	$ —	$45,478
Commercial paper	199,647	—	—	199,647
Corporate bonds	179,336	18	(332)	179,022
U.S. Treasury and government sponsored enterprises	16,295	—	(32)	16,263
Total	$440,756	$ 18	$ (364)	$440,410

Gains and losses on the sales of investments available-for-sale were nominal during both the three months ended March 31, 2018 and 2017.

The fair value of and gross unrealized losses on investments available-for-sale in an unrealized loss position were as follows (in thousands):

	March 31, 2018					
	In an Unrealized Loss Position Less than 12 Months		In an Unrealized Loss Position 12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds	$167,459	$ (822)	$9,077	$ (21)	$176,536	$ (843)
U.S. Treasury and government sponsored enterprises	17,000	(52)	2,655	(5)	19,655	(57)
Total	$184,459	$ (874)	$11,732	$ (26)	$196,191	$ (900)

	December 31, 2017					
	In an Unrealized Loss Position Less than 12 Months		In an Unrealized Loss Position 12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds	$140,746	$ (296)	$20,047	$ (36)	$160,793	$ (332)
U.S. Treasury and government sponsored enterprises	13,611	(23)	2,651	(9)	16,262	(32)
Total	$154,357	$ (319)	$22,698	$ (45)	$177,055	$ (364)

There were 150 and 134 investments in an unrealized loss position as of March 31, 2018 and December 31, 2017, respectively. During the three months ended March 31, 2018 and 2017 we did not record any other-than-temporary impairment charges on our available-for-sale securities. Based upon our quarterly impairment review, we determined that the unrealized losses were not attributed to credit risk, but were primarily associated with changes in interest rates. Based on the scheduled maturities of our investments and our determination that it was more likely than not that we will hold these investments for a period of time sufficient for a recovery of our cost basis, we concluded that the unrealized losses in our investment securities were not other-than-temporary.

The fair value of cash equivalents and investments by contractual maturity were as follows (in thousands):

	December 31,	
	2018	2017
Maturing in one year or less	$410,062	$377,155
Maturing after one year through five years	94,210	63,255
Total	$504,272	$440,410

Table of Contents

NOTE 5. INVENTORY

Inventory consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Raw materials	$ 1,937	$ 498
Work in process	3,726	3,997
Finished goods	2,977	2,854
Total	$ 8,640	$ 7,349

Balance Sheet classification:		
Inventory	$ 7,563	$ 6,657
Other long-term assets	1,077	692
Total	$ 8,640	$ 7,349

A portion of the manufacturing costs for inventory was incurred prior to regulatory approval of CABOMETYX and COMETRIQ and therefore was expensed as research and development costs when those costs were incurred, rather than capitalized as inventory. As of both March 31, 2018 and December 31, 2017 our inventory includes $0.4 million of materials that were previously expensed.

Write-downs related to excess and expiring inventory are charged to either Cost of goods sold or the cost of supplied product included in Collaboration revenues. Such write-downs were $0.5 million for the three months ended March 31, 2017. There were no such write-downs for the three months ended March 31, 2018.

Inventory expected to be used or sold in periods more than 12 months from the date presented is classified as Other long-term assets on the accompanying Condensed Consolidated Balance Sheets. As of both March 31, 2018 and December 31, 2017, the non-current portion of inventory consisted of finished goods.

NOTE 6. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following (in thousands):

	March 31, 2018	December 31, 2017
Computer equipment and software	$ 14,772	$ 14,146
Laboratory equipment	5,959	5,959
Leasehold improvements	4,715	4,715
Furniture and fixtures	1,609	1,609
Construction in progress	41,528	22,114
	68,583	48,543
Less: accumulated depreciation and amortization	(23,171)	(22,800)
Property and equipment, net	$ 45,412	$ 25,743

Depreciation expense was $0.4 million and $0.3 million for the three months ended March 31, 2018 and 2017, respectively.

Build-to-Suit Lease

On May 2, 2017, we entered into a Lease Agreement (the “Lease”) with Ascentris 105, LLC (“Ascentris”), to lease 110,783 square feet of space in office and research facilities located at 1851, 1801, and 1751 Harbor Bay Parkway, Alameda, California (the “Premises”). On October 16, 2017, we executed an amendment to the Lease for 19,778 square feet of additional space located at the Premises with terms consistent with the original Lease. For a description of the Lease, see “Note 12. Commitments” to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 26, 2018.

Table of Contents

In connection with the Lease, we received a tenant improvement allowance of $7.7 million from Ascentris, for the costs associated with the design, development and construction of tenant improvements for the Premises. We are obligated to fund all costs incurred in excess of the tenant improvement allowance and to certain indemnification obligations related to the construction activities. We evaluated our involvement during the construction period and determined the scope of the tenant improvements on portions of the Premises, including the building shells, did not qualify as "normal tenant improvements" under Accounting Standards Codification Topic 840, Leases. Accordingly, for accounting purposes, we are the deemed to be the owner of such portions of the Premises during the construction period. As such, we will capitalize the construction costs as a build-to-suit property within Property and equipment, net, including the estimated fair value of the building shells that we are deemed to own at the lease inception date, as determined using a third-party appraisal. The capitalized construction costs also include the estimated tenant improvements incurred by Ascentris. Accordingly, we capitalized $14.5 million of costs related to the Lease in construction in progress as of May 2, 2017, with a corresponding build-to-suit lease obligation in Other long-term liabilities. As of March 31, 2018, we have capitalized an additional $26.8 million of construction in progress for tenant improvements related to the Premises. As of March 31, 2018 and December 31, 2017, we had also prepaid an additional $0.6 million and $11.1 million, respectively, for future constructions costs which is included in Other long-term assets on the accompanying Condensed Consolidated Balance Sheets.

NOTE 7. STOCK-BASED COMPENSATION

We recorded and allocated employee stock-based compensation expense for our equity incentive plans and our 2000 Employee Stock Purchase Plan ("ESPP") as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Research and development	$3,033	$1,478
Selling, general and administrative	6,272	3,235
Total stock-based compensation	$9,305	$4,713

We have several equity incentive plans under which we have granted stock options and restricted stock units ("RSUs") to employees, directors and consultants. At March 31, 2018, 19,972,317 shares were available for grant under our equity incentive plans.

We use the Black-Scholes Merton option pricing model to value our stock options and ESPP purchases. The weighted average grant-date fair value per share of our stock options and ESPP purchases was as follows:

	Three Months Ended March 31,	
	2018	2017
Stock options	$11.52	$9.92
ESPP	$7.39	$3.71

The grant-date fair value of employee stock option grants and ESPP purchases was estimated using the following assumptions:

	Three Months Ended March 31,			
	2018		2017	
Stock options:				
Risk-free interest rate	2.40	%	1.62	%
Dividend yield	—	%	—	%
Volatility	54	%	64	%
Expected life	4.0 years		4.0 years	
ESPP:				
Risk-free interest rate	1.53	%	0.62	%

Dividend yield	—	%	—	%
Volatility	53	%	68	%
Expected life	6 months		6 months	

Table of Contents

We considered our implied volatility and our historical volatility in developing our estimates of expected volatility. The assumptions for the expected life of stock options were based on historical exercise patterns and post-vesting termination behavior.

The fair value of RSUs was based on the closing price of the underlying common stock on the date of grant.

Stock option activity for the three months ended March 31, 2018 was as follows (dollars in thousands, except per share amounts):

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Options outstanding at December 31, 2017	22,208,446	$ 6.83		
Granted	293,580	$ 25.72		
Exercised	(288,196)	$ 6.69		
Forfeited	(18,484)	$ 12.04		
Options outstanding at March 31, 2018	22,195,346	$ 7.08	3.86 years	$ 339,631
Exercisable at March 31, 2018	16,497,014	$ 4.66	3.30 years	$ 288,535

As of March 31, 2018, $38.8 million of unrecognized compensation expense related to unvested stock options will be recognized over a weighted-average period of 2.47 years.

RSU activity for the three months ended March 31, 2018 was as follows (dollars in thousands, except per share amounts):

	Shares	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
RSUs outstanding at December 31, 2017	3,762,990	$ 17.76		
Awarded	146,790	$ 25.72		
Vested and released	(197,884)	$ 6.30		
Forfeited	(24,494)	$ 17.89		
RSUs outstanding at March 31, 2018	3,687,402	$ 18.69	1.83 years	$ 81,676

As of March 31, 2018, $60.0 million of unrecognized compensation expense related to unvested RSUs will be recognized over a weighted-average period of 3.05 years.

NOTE 8. INCOME TAXES

Provision for income taxes was as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Provision for income taxes	$ 2,514	$ 134

Provision for income taxes for the three months ended March 31, 2018 and 2017 primarily relates to state taxes for which we do not have net operating loss carry-forwards due to a limited operating history. Our historical losses are sufficient to fully offset our federal taxable income.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 was signed into law. The Tax Cuts and Jobs Act contained significant changes to corporate taxation, included among other items, a reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21%. Further guidance may be forthcoming from the FASB and the SEC, as well as regulations, interpretations and rulings from federal and state tax agencies, which could result in additional impacts. The Provision for income taxes for the three months ended March 31, 2018 did not reflect any adjustment to the

impact of the Tax Cuts and Jobs Act enactment that we recorded during the year ended December 31, 2017.

Table of Contents

NOTE 9. NET INCOME PER SHARE

The computation of basic and diluted net income per share was as follows (in thousands, except per share amounts):

	Three Months Ended March 31,	
	2018	2017
Numerator:		
Net income	$115,857	$16,700
Net income allocated to participating securities	—	(57)
Net income allocable to common stock for basic net income per share	115,857	16,643
Adjustment to net income allocated to participating securities	—	3
Net income allocable to common stock for diluted net income per share	$115,857	$16,646
Denominator:		
Weighted-average shares of common stock outstanding used in computing basic net income per share	296,421	290,870
Dilutive securities:		
Outstanding stock options, unvested RSUs and ESPP contributions	17,270	18,665
Weighted-average shares of common stock outstanding and dilutive securities used in computing diluted net income per share	313,691	309,535
Net income per share, basic	$0.39	$0.06
Net income per share, diluted	$0.37	$0.05

The two-year warrants to purchase an aggregate of 1,000,000 shares of our common stock issued in January 2014 (“2014 Warrants”) were participating securities. The warrant holders did not have a contractual obligation to share in our losses. The 2014 Warrants were fully exercised in September 2017. For a description of the 2014 Warrants, see “Note 7. Common Stock and Warrants” to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 26, 2018.

Potentially dilutive shares of common stock not included in the computation of diluted net income per share because to do so would be anti-dilutive were as follows (in thousands):

	Three Months Ended March 31,	
	2018	2017
Outstanding stock options, unvested RSUs and ESPP contributions	1,907	1,396
Secured Convertible Notes due 2018 (“Deerfield Notes”)	—	33,890
Total potentially dilutive shares	1,907	35,286

The Deerfield Notes were repaid in June 2017.

Table of Contents

NOTE 10. FAIR VALUE MEASUREMENTS

The classification of our financial assets within the fair value hierarchy that were measured and recorded at fair value on a recurring basis was as follows; the amounts presented exclude cash, but include investments classified as cash equivalents (in thousands):

	March 31, 2018		
	Level 1	Level 2	Total
Money market funds	$55,241	$ —	$55,241